CDC BOARD OF DIRECTORS
March 16, 1984

R. M. PRICE

I. 1984 BUDGET AND YTD RESULTS

At the January Board of Directors meeting I briefly mentioned that we had not yet finished the 1984 budgets but, were striving to attain a budget earnings level in excess of $4.50 a share. We've now completed the budgets at that level and are busy with making it all happen. As I mentioned in the January meeting, the budget process this year was an extremely difficult task. We all wanted to come up with a budget that portrayed a material improvement over 1983 performance. For one thing, after two straight years of toughing it out, people need the psychological boost that comes from robust revenue and earnings growth.
However, as we dug through each of the businesses in putting a detailed budget together, we found ourselves faced with the situation that, because of shipments of new products, improvement in both the computer and peripherals hardware business is skewed heavily toward the second half of the year. You will recall we had some of that problem in 1983 and this year if anything is moreso. There is always risk involved when the plan is patterned that way. The single biggest risk area is the IBM end user plug compatible disk business which is budget for a pre-tax loss of $22.2M this year -- and that assumes heavy third and fourth quarter shipments. As I mentioned in January, we have a task team studying the short and long range future of this business. Although I'm not in a position to quantify it precisely for you, whatever recommendation that task team comes up with, it will entail a one-time write-off in 1984 of approximately $20M.
Also, although there is improvement budgeted in the Services business, it is not to the extent we would have liked. The Cybernet business, both internationally and in the U.S., continues to have problems in attaining increased revenue levels. In addition, we are making an additional P&L investment by the acquisition of United Information Services. We believe this is the right strategy for the longer term even if it does depress profits some in 1984.

Commercial Credit is faced with the difficult task of continuing new strategies, with new products, and reducing people and overhead expense at the same time. Commercial Credit is budgeted to improve 1983 pre-tax results by $18.4M or about 66% -- and if you remember that their earnings were enhanced in 1983 by several one-time events, the actual required operating improvement is even greater. The fundamental health of Commercial Credit is measured by its operating profits and these must increase by over $30M in 1984.
Summarizing, the Computer business is budgeted to increase revenues some 16% which is a healthy growth rate. Pre-tax profit is budgeted at $200M for the Computer Business and $45M for Commercial Credit. In total, then, we have a pre-tax profit budget of $245M, up nearly 15% over 1983. This is a good growth but less than revenue growth -- the principal factors being no improvement in gross margins and somewhat higher interest expense. Net earnings are only budgeted to increase 9% and total $176M or $4.50 a share compared to $4.20 a share last year. The reason earnings are not increasing at the same rate as pre-tax profit is because we have budgeted a higher tax rate. The tax rate was an unusual 21.5% in 1983 and we do not feel we can realistically maintain that level of taxes. So when you net it all down, we have labored pretty damn hard to come up with a respectable but by no means exhilarating budget.
Currently included in the balance sheet budget is a capital expenditure of $250M, an increase of $100M over last year's budget. Even though there is the absolute necessity for increased investment in production facilities for new products, this is too high and too big of an increase. It is in the process of being re-scrubbed and reduced to a more realistic level. Accordingly, we will not be presenting the capital equipment budget today as shown on the agenda, but will defer to the May meeting. Once we've completed this effort, the budgeted ROIC of 6.7% should improve to something equal to or better than last year's 7.1%.

In summary, 1984 looks like it will be another very tough year. In fact, as you just heard from the operating executives and Chuck Roskam, the first two months performance, excluding the sale of the Gulf building, is less than last year's operating performance. In addition, in 1983 we had a very strong month in March and ended the first quarter with 88¢ per
share earnings. The budget for the first quarter of 1984, including the building sale, is 69 cents, so even though we are slightly ahead of budget and ahead of last year at the end of February, it does not look like we will match last year's earnings per share for the first quarter.

II. MARKETING AND SALES

Revenue for the first two months is 13% ahead of last year. That is less than the overall 16% growth rate I indicated we have budgeted for the full year because of the late-year skew. Revenue in total is fairly close to budget but we have the continuing pattern of pluses and minuses amongst individual business segments that means we really aren't hitting on all cylinders.

Some things have improved -- for example OEM Peripherals are showing a healthy 33 percent increase year-to-year. Data Services, although still not back to previous growth rates, is
up 10.2 percent. On the other hand, Vocational Education, which enjoyed robust growth in 1983, is only up by 2.3 percent for the first two months of this year.

We have discussed the product transitions -- e.g. in Data Services, Peripherals, and Financial Services, which have affected growth rates for the recent past and those factors, though they will lessen throughout 1984, are still continuing. In such periods, it is doubly important to work extra hard at the daily selling task. Last year we emphasized that importance and it helped. With the help of an improved corporate marketing staff function under Tom Miller, there is going to be even more emphasis this year.

All of you are well aware what a prolonged period of tough sales can do to the morale of a sales organization and I know the last two years have taken their toll in that regard. So attention to the selling task and those who have it is a matter of some priority for top management.
III. EDUCATION

Having mentioned education -- or rather the vocational part of it -- I thought I would take a few minutes to recapitulate the various pieces and the size of Control Data's education business. We have found even in members of the Management Committee some confusion in that regard so I thought a minute or two on the subject might be appropriate here as well.

In 1964, Control Data and the University of Illinois started development of PLATO. The objectives were to develop an educational computer-based environment. Although we still fund some research work at the University of Illinois, for the past several years Control Data has mostly gone its own way. The total development effort produced a large amount of technology:
- Ease of use capabilities -- based on human factor studies used in our applications and systems.

- Development tools -- to create an educational environment.

- Courseware -- educational applications.

- Delivery systems -- ranging from micros to large network computer systems.

- The know-how to operate schools and education centers.

- Learning management -- for prescribing, directing, monitoring and tracking of an individual's progress.

In addition to providing value added to many Control Data products and services, this technology has resulted in several profit centers, explicitly devoted to education and training in various markets.
Training and education permeates all of Control Data's businesses today. The organizations that comprise the majority of our PLATO training and education businesses are:

- Vocational Education Services -- CDI, Medix, Educational Centers, Employment Preparation Seminars

- PLATO Training and Education -- Business/Industry Government and Academix

- International PLATO Operations

Other organizations that contribute to the training and education business are:

Our computer-based education and training businesses were profitable in the fourth quarter of 1983 and are planned for profitability in 1984.

The revenue breakdown for Education Services is shown on this chart. As you can see, the explicit Education Services amounts to about $157 million with the education component of other services amounting to another $7 million. The pre-tax profit of the explicit Education Services -- i.e. the $157 million is budgeted to be $3.8M.

IV. EMPLOYMENT PREPARATION/FAIR BREAK

The name "Fair Break" I know is familiar to you and I was reminded that it doesn't even appear on the chart I have just shown. Well, Fair Break is alive and robust as a part of
"Employment Preparation Services." In fact, that is where almost all the revenues of EPS come from. To refresh your memories, I also have as a handout a new Fair Break brochure which has just been produced.

Fair Break delivers to disadvantaged, unemployed people a range of employment preparation programs from remediation and work readiness on up to vocational training for entry level jobs in high tech industries. All programs are built around PLATO delivery and use courseware products from other education business units, e.g., academic, vocational, and business and industry.

Starting with an initial pilot program in St. Paul in 1978, the business has grown from a handful of accounts in mid-1979 to a $12 million (revenue) business (1983) with 24 programs in operation currently across the U.S. A 60 percent growth rate
is projected for 1984 with primary funding coming from local service delivery areas (SDA's) authorized under the new Job Training Partnership Act. Fair Break programs have also been a primary penetration point for Control Data into the corrections marketplace with programs currently in at least 13 states.

IV. MCC

The tempo of activity is picking up at MCC. Our board meeting was last week. BMC became the 15th company to join MCC. There are now 76 project people on board, 34 of whom are from shareholder companies -- 11 from Control Data. We also have another 23 candidates being considered. The projects are beginning to work -- these projects are still refining their objectives and scope of work but the other four are formally launched. One sign of progress is that attention is already shifting to the technology transfer aspects of MCC activities.
and there was considerable board discussion on this subject.

It's far too early to comment on the quality of research or particular expected benefits for Control Data, but the quality of people attracted to MCC appears to be excellent so that bodes well for the future.

The only even slight worry I have is that MCC would be better off if it could get out of the media limelight for a while. Doing applied research in the glare of public attention is not the most propitious of circumstances. Likewise, without so much public attention, it will be easier to solve the inevitable squabbles that arise in any cooperative endeavor once the "honeymoon" period is over.

V. ETA

Bill will comment on the general subject of supercomputers and you are going to have a tour here today as well, so my comments
will only deal briefly with ETA. ETA seems to be settling well into the tough task of getting a new supercomputer out the door in the next 30 months. Listening to Tony Vacca -- the chief technologist -- by the way is an experience in being impressed that everyone should have. Still and all the task -- and the software part of it in particular -- looks very, very tough to me.

With regard to financing, there are also some tough aspects. Just obtaining the money required to fund ETA over the next few years will probably not be particularly difficult. In fact, ETA has been approached by a number of investment bankers who want to raise funding for them. And work is underway aimed at raising a modest amount -- about $10M -- through a private placement. With that, some customer advance payments and equipment financing, ETA will have cash sufficient to their needs at least through the first half of 1985.
So money availability isn't the immediate problem. The problem is selling an R&D limited partnership which would provide some money, but more importantly, would relieve Control Data's P&L of the burden of all those development expenses of ETA.

Unfortunately, the market for R&D partnerships, even though it wasn't too good before, has gotten worse of late -- with the abandonment of one by Storage Technology and additional delays recently announced by Trilogy. So the uncertainty is increased but we are going to try, nonetheless, and we'll know one way or the other before the next board meeting.

VI. SUMMARY

Finally, a few notes of overall perspective. The numbers for 1984 thus far do not reflect the real progress I know we have made. For example, as just noted, we are carrying the full brunt of ETA -- for the first quarter that's some $5.4M
pre-tax. Yields in BPG have increased from mid-40's to mid-60's and that change is only beginning to be reflected in gross margins. Data Services revenues are growing once again at a double digit rate but pre-tax results are depressed by that task of fixing UIS. Small Business Services have made a lot of excellent product, marketing, and organizational change as well as cost reductions that as yet are only minimally reflected in their pre-tax profit. The basic hardware products are in better shape strategically than in three years. And so the outlook for 1984, although tough and in any event not off to a robust start, is nevertheless very good.